STATE of INDIANA

INDIANAPOLIS 46204

INDIANA UTILITY REGULATORY COMMISSION
302 W. WASHINGTON STREET, ROOM E306

June 4, 1997

The Honorable John D. Dingell
Committee on Commerce
U.S. House of Representatives
Room 2125, Rayburn House Office Building
Washington, D.C. 20515-6115

Dear Representative Dingell:

Enclosed is the Indiana Utility Regulatory Commission's response to your survey regarding the electricity industry. We hope the response is helpful to the work of the committee. We commend you for seeking to better understand the public policy and legal issues involved, particularly as they affect the states, prior to considering drafting legislation that would restructure that industry. If we can be of further assistance, please contact us.

Very truly yours,

John F. Mortell

John F. Mortell
Chairman

JFM/lc

Enclosure:

Whether or Not Congress Should Enact Legislation Concerning Electricity Industry

1. ***Has your Commission or State legislature considered or adopted retail competition? If retail competition is occurring at this point, what effect has it had on consumer prices?***

A detailed bill (SB 427) to restructure and deregulate the electric utility industry in Indiana by June 30, 2004, was introduced in the Indiana General Assembly in the 1997 session. The substantive portions of the bill were removed and it was amended to only require the Regulatory Flexibility Committee to "study competition and deregulation in the electric utility industry." The bill, in this form, passed both houses of the legislature and was signed into law by the Governor. The Regulatory Flexibility Committee was established in 1985 to monitor competition in the telephone industry, with the monitoring of the energy utility industry added to the committee's responsibilities in 1995. The committee is composed of the members of the house commerce committee and the senate commerce committee.

Beginning in December 1994, the IURC has hosted Electricity Forums among the state's electric utilities, consumer groups and other interested parties. Through these forums, these parties have provided the IURC with insight regarding how, if at all, to best alter electric utility regulation.

2. ***Has your State asked Congress to enact legislation mandating retail competition?***

No.

Has it sought Congressional action to enable or assist it in adopting retail competition?

No.

Has it requested or recommended any other type of Congressional action?

No.

3. ***Does your Commission currently have sufficient authority to resolve stranded cost issues in the event Congress enacts legislation providing for retail competition by a date certain? If not, what timing and other problems might ensue? What could Congress do to address any such problems?***

Although the IURC may have sufficient authority to generally resolve issues such as stranded cost,[1] there is a lack of express statutory authority dealing specifically and clearly with stranded cost. This circumstance could result in litigation if the IURC is confronted with stranded cost issues. To address this potential problem, Congress could provide for a reasonable period of time for the legislatures of states such as Indiana to adopt enabling or clarifying legislation.

4. ***Are there any other areas in which your State currently does not have the necessary authority to address issues arising from federal legislation mandating competition, or repeal of the Public Utility Holding Company Act of 1935 (PUHCA) or the Public Utility Regulatory Policies Act of 1978?***

It is impossible to determine whether or not the IURC has the necessary authority to address issues arising from federal legislation mandating competition without knowing the provisions of that mandate. Present Indiana law, I.C. 8-1-2.3-4(a), states:

> As long as an electricity supplier continues to provide adequate retail service, it shall have the sole right to furnish retail electric service to each present and future consumer within the boundaries of its assigned service area and no other electricity supplier shall render or extend retail electric service within its assigned service area unless the electricity supplier with the sole right consents thereto in writing and the commission approves.

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[1] "The right and power of the commission to authorize an accounting system under which reserves are set up for . . . future losses and contingencies is an administrative matter and, so long as such procedure is within reason and prudence, the trial court has no right to interfere. . .. We judicially know that good accounting practices require reserves for losses and contingencies which accrue in the future because of current operations," Boone County REMC v. PSC, 155 NE 2d 121, 126.

The IURC currently has limited authority to address issues arising from a repeal of PUHCA. I.C. 8-1-2-49 provides the IURC with authority over affiliates having transactions with public utilities under the jurisdiction of the IURC to the extent of access to all accounts and records of joint or general expenses which may be applicable to such transactions, and authority to require the submittal of reports by such affiliates. In addition, the IURC is authorized to disapprove certain contracts between a public utility and an affiliate if the terms of such a contract are contrary to the public interest.

5. ***Would any constitutional issues be raised by federal legislation:***

a. ***Mandating that states choose between adopting retail competition by a date certain and having a federal agency preemptively impose retail competition?***

b. ***Requiring states to conduct a proceeding on retail competition, reserving to the states discretion not to adopt retail competition if they determine doing so would not be in its consumers' best interests?***

Such legislation could impose pervasive federal regulation on the retail electric energy market, a segment of commerce that the federal government has previously regulated in only a limited manner. In the process, comprehensive state regulation of this market would be preempted.

The Supreme Court of the United States has handled the question of federal preemption on a fact-sensitive basis. The degree of preemption weighed against the impact on the historic evolution of legislation and judicial interpretation in a specific area becomes the crucial factor most often used to resolve a dispute involving state and federal jurisdiction.

The application of the Commerce Clause to recent fact situations and its narrowing of the authority by Congress over the states, as reviewed by the courts, present a difficult problem where there is no consistency in either the facts in the specific case or the legal issue subject to the controversy.

Review of the deregulation of natural gas, as well as the more recent commencement of telephone deregulation, provides little substantive guidance to the parameters of permissible federal preemption and the very complex dissection and segmentation involved in electricity deregulation.

If the purpose is to stimulate a truly competitive market for the purchase and sale of electricity, there should be no need to straitjacket the states with federal preemption-imposed dates. The ability to accomplish one precludes the need to impose the other.

6. ***From a practical standpoint, what problems would arise if Congress adopted legislation mandating retail competition which did not grandfather prior state action?***

It is difficult to say what problems would arise, because it depends on the specific circumstances; i.e., what state actions have taken place in relation to the particulars of the congressional legislation. Failure to grandfather state restructuring activities could reopen previously settled issues which might give some stakeholders an opportunity to disrupt state restructuring activities. This type of disruption could cause a considerable delay in the transition to retail competition. Without "grandfathering," states such as Indiana could be discouraged from taking action at the present time if federal legislation may later preempt those state initiatives.

7. ***In hearings before the Energy and Power Subcommittee during the last Congress, some witnesses took the position that Congressional legislation mandating retail competition is necessary to protect the interests of small and residential consumers. This was based on the assertion that large industrial customers are able to negotiate lower rates with state utility commissions, and that the incidence of such rate reductions is on the increase.***

    a. ***Are you aware of any study or analysis relevant to your State that supports this conclusion?***

No.

    b. ***Please provide any information you can on the historical relationship between residential and industrial rates, the extent to which one customer class has subsidized another, and whether or not this trend has altered in recent years.***

Historically, industrial rates generally subsidize residential and commercial rates. In the past 15 years the IURC has taken steps to eliminate subsidies between rate classes gradually on a case-by-case basis using embedded "cost of service" analysis. Please refer to response to Question 8 for specific rate trends.

8. ***Although electricity rates vary widely within the U.S., they have fallen recently in some parts of the country. Please provide any information you can about rate trends in your State, and how they affect various customer classes.***

For the state of Indiana, average inflation-adjusted prices per kWh declined 32.8% from 1985 to 1994. The declines were 28.4% for the residential sector, 33.3% for the commercial sector and 34.0% for the industrial sector.

Indiana Average Price of Electricity Sold (1985-1994)
(based on 1987 dollars)

Year	Commercial	Average Price cents/kWh)		Total
		Residential	Industrial	
1985	6.6	7.4	5.0	6.1
1986	6.8	7.5	5.1	6.3
1987	6.6	7.2	4.6	6.0
1988	6.4	6.8	4.4	5.7
1989	5.4	6.4	4.0	5.1
1990	5.1	6.0	3.8	4.8
1991	4.9	5.6	3.6	4.6
1992	4.6	5.6	3.5	4.4
1993	4.4	5.3	3.3	4.2
1994	4.4	5.3	3.3	4.1

Source: Energy Report to the Regulatory Flexibility Committee of the Indiana General Assembly, Vol. 1, Electric Utility Industry, Nov. 1996, p. 33.

9. ***Some proponents of retail competition hold the view that all electricity resources should be sold at a market price and that state authority to regulate retail rates should be eliminated. How would such a policy affect shareholders and ratepayers? What mechanisms could states or Congress employ to manage these issues? In a restructured***

electric industry, who should receive the benefits of these low-cost resources -- utility ratepayers, utility shareholders or the highest bidder?

We assume the statement that includes "all electricity resources" refers to generating resources only. The generally accepted model for restructuring the electric utility industry appears to have evolved to this structure: generation would be completely deregulated, while transmission and distribution would continue to be regulated, although the form or type of regulation might change. We use this presumption for our response.

The goal should be to make the generation market as competitive as possible; not to attempt to allocate the benefits of competition to various stakeholders. If a truly competitive market is created, all consumers should benefit; however, benefits to shareholders will vary depending on the competitiveness of the companies in which they invest.

To bring about effective competition, potential market power through vertical integration should be minimized by the separation of generation from transmission and distribution. Control of transmission service by an independent system operator (ISO) that is separate from the owners of generation would be a desirable outcome. Proper pricing and control of the transmission component of the electrical system is essential to maximizing competition in the generation market.

Even if generation is completely deregulated, state and federal government must oversee the transition to competition to ensure that reliable electric service is maintained and that the goals of competition are achieved. This oversight role is especially important during the transition period from a regulated market to a competitive one.

10. Of those states which have adopted retail competition, how many have addressed the issue of "reciprocity", (that is, whether or not the state can bar sellers located in states which have not adopted retail competition from access to its retail markets)? Whose interests does a reciprocity requirement affect? Is a reciprocity requirement the only way to protect those interests, or are there alternatives? Would such a requirement raise constitutional issues?

We have not conducted a thorough study of the actions of other states to adopt retail competition, and therefore do not know how many have addressed reciprocity. The effectiveness of retail competition for any state depends upon the extent of generation competition. It is not at all clear how the imposition of a reciprocity requirement, or the lack thereof, would impact the extent of competition in the generation market. Given this uncertainty it is very difficult to determine whose interests would be served by a reciprocity requirement. There are concerns of fairness if Indiana opens its retail electric market but, for example, Ohio does not. Without a reciprocity requirement electric generators in Indiana could be denied access to the market in Ohio while being subject to competition within Indiana from Ohio-based generators. Some Indiana customers might benefit but it could be a detriment to generators in Indiana.

Legal concerns have been expressed in Indiana that a pure reciprocity requirement (forbidding the sale of electricity in a state from a generator that is located in a state that does not permit retail competition) may be an undue burden on interstate commerce. One possible option to a pure reciprocity agreement may be to permit retail purchases of electricity from a generator regardless of whether or not that generator's state permits retail competition, but to provide for the state commission in the receiving state to protect the incumbent utility via access charges or other measures.

11. If Congress were to require "unbundling" of local distribution company services as part of a retail competition mandate, what practical problems might this present to state regulators?

One valuable lesson from the transition to competition in telecommunications is the high degree of confusion experienced by consumers for a significant period of time following the initiation of restructuring activities. Requiring individual components of local distribution service to be offered and priced distinctly would increase the general level of confusion that consumers would otherwise experience. The unfamiliarity of consumers with purchasing unbundled electricity services means that states must be especially concerned with consumer education and protection.

12. Does your Commission face particular problems in connection with public power or federal power in an increasingly competitive electricity market?

Indiana does not face any unique problems in connection with public power in an increasingly competitive electricity market. There are no federal power generating facilities in Indiana.

13. How would federal legislation mandating competition by a near term date certain affect funding needs for your Commission? If additional funding were needed, would it be available, and what problems might arise if it were not?

The Telecommunications Act of 1996, the goal of which is to introduce competition to all segments of the telecommunications industry, delegates considerable responsibility to state commissions to implement many important sections of the Act. Congress provided no funding to the states to compensate for the mandates of the Act. The IURC has limited resources and the new responsibilities under the Telecommunications Act will require innovative use of those resources to meet responsibilities.

Federal legislation mandating competition in the electric utility industry by a near-term date certain without providing for additional resources would be extremely difficult to implement. The original version of the bill (SB 427) to introduce competition in the Indiana electric utility industry by 2004, discussed in response to Question 1, recognized the need for additional resources. The bill required the IURC to study the requirements of the act and estimate the resources necessary to perform its responsibilities under the act in a timely and adequate manner, and submit a report to the Legislature concerning the additional resources that it might need.

Indiana government prepares its budget on a biennial basis, i.e., the Indiana General Assembly approves a two-year budget each odd-numbered year, which commences July 1 of that year. The ability to acquire additional resources in a timely manner would depend on the timing of passage of any federal statute and the dates of implementation of a federal act that mandated retail competition.

14. ***Has your Commission considered or adopted securitization plans as a means of providing for recovery of utility stranded assets? What risks are inherent in this approach, and who bears them?***

No. The IURC has not yet analyzed securitization as a means of recovering stranded costs.

15. ***There is a wide divergence of opinion as to whether or not PUHCA should be modified or repealed. Given the record level of merger activity, this question may become significant for all state regulators, whether or not they currently have regulatory responsibilities relating to registered holding company activities.***

a. Do you believe PUHCA impedes competition, at the wholesale or retail level? Can "effective competition" be achieved regardless of whether Congress enacts changes to PUHCA?

The IURC does not believe that PUHCA can stop the development of effective competition at the wholesale or retail level. However, the IURC does believe that registered holding companies are disadvantaged compared to exempt holding companies in their ability to respond to changing market conditions and opportunities. This asymmetry between registered and exempt holding companies could affect economic efficiency at the wholesale and retail level.

b. Do you believe Congress should modify or repeal PUHCA? If so, why, and under what if any conditions?

The IURC perceives a continued need for federal oversight of multi-state holding companies for a variety of reasons. To accomplish this, PUHCA should be reformed rather than repealed at this time. The IURC believes that the following criteria should be observed to evaluate changes to PUHCA:

1. The playing field for exempt and registered holding companies should be leveled so that registered companies are not significantly disadvantaged in their attempts to participate in increasingly competitive markets.

2. Proposals should not mandate state commissions to take on additional regulatory burdens. Changes to PUHCA would be premature if they do not provide for a transition period that allows state commissions an opportunity to acquire the necessary resources, expertise and statutory authority to participate in the regulation of registered holding companies.

3. Proposals must recognize a logical assignment of regulatory responsibility between the federal government and the states. The ability of states to meaningfully regulate operating companies serving their citizens must not be infringed. Alternatively, the multi-state character of registered holding companies necessitates the continuation of some form of federal oversight to avoid gaps that the states cannot fill.

The very nature of multi-state holding companies, and the limitations on state regulatory bodies to police their activities, requires the continuation of some form of federal regulation. PUHCA explicitly recognized particular holding company abuses and sought to alleviate them when it was enacted. The potential opportunity and motivation for abuse remains. Affiliate transactions are not at arm's length. All are members of one corporate family, have the same owners, and many employees of the non-regulated subsidiaries or parent are former employees of the regulated entity. Until the transformation to primarily competitive markets is more pervasive and complete, competition will aggravate rather than alleviate the tendencies of holding companies to subsidize non-regulated activities through overcharges and the misallocation of common costs to the utility, transferring intangible benefits from the regulated to the unregulated at no cost, and charging ratepayers for research and development that eventually benefits the unregulated.

c. ***Should Congress enact legislation to modify the holding in <u>Ohio Power Co. V. FERC</u>, 954 F.2d 779 (D.C.Cir. 1992)?***

Yes. The IURC regulates operating companies of American Electric Power Company and Cinergy. As a consequence of our regulation of these registered holding companies, the IURC is keenly interested in resolving the problems of conflicting jurisdictions. While Ohio Power Co. v. FERC dealt with fuel costs, the IURC is concerned that the conflict between the PUHCA and the Federal Power Act may not be limited to fuel purchases. There is a strong probability that there will be a proliferation of subsidiaries as well as a wide-range of other costs that will be at issue in the future. Consumer and shareholder protections against abusive actions between the parent and its affiliates cannot be adequately assured with the present holes in the patchwork quilt system of regulation.